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Structural Changes in China's Import and Implications for the Korean Economy

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China's total trade amount in 2015 recorded 3,882 billion dollars, a 9.6% decrease compared to last year. In particular, imports (-18.4%) have dropped by a larger percentage than exports (-2.7%), and the degree of the fall is larger than in 2009 (-11.3%), when the global financial crisis hit economies.

The causes behind this dramatic decline of China's imports are numerous, including the slowdown of the global economy, drops in global raw material prices, and increase of import substitution thanks to enhanced industrial structures. But the main underlying cause is that processing trade has decreased as the Chinese government undertook a policy transition from a growth strategy focused on investment and export to one led by

domestic demand.

In the past, China sought economic development by boosting its processing trade based on its abundant labor power, and implemented various preference policy to attract foreign direct investment (FDI). Backed by these efforts, the annual average increase rate of China's export and import in 2001-2010 recorded 21.8% and 21.4% respectively, and China served as the 'World Factory'. However, a rise in negative influences such as the escalation of trade conflicts and deepening environment pollution led the Chinese government to implement a control policy on the processing trade after the mid-2000s, which is why the growth rate of processing imports has gradually slowed down (17.8% in 2001-2010 → 3.7% in 2011-2014).

Changes in China's growth strategy and economic structure are influencing China's import structure, and Korea, 26% of whose exports depend on China, need to reestablish its export strategy to China by accurately understanding structural changes in China's imports.

China's import volume reached 1,963 billion dollars in 2014. This accounts for 10.5% of the world's total import, which is second only to the U.S. However, the growth rate of China's import has suffered a slowdown, falling from an annual average of 21.4% in 2001-2010 to 4.1% in 2011-2014.

When classifying China's import by form of trade, the weight of general trade has been expanding gradually since the late 2000s. As the weight of processing trade fell from 32.1% (2009) to 26.8% (2014), the weight of general trade, in contrast, rose from 53.1% to 56.5%, making China's import structure all the more focused on general trade. The average annual growth rate of general trade imports during the same period recorded 15.7%, which is higher than the growth rate (10.2%) of processing trade imports.

When looking into the changes in import structure by processing phase in 2009-2014, China's import structure is still focused on intermediary goods (54.7% → 47.6%), but its share is on a gradual decline. Meanwhile, the imports of consumer goods (4.4% → 7.2%) and preliminary products (22.9% →26.5%) are gradually taking up a larger share. The evaluation is that the weight of intermediary goods and capital goods have fallen due to the promotion of materials and components industry, the control policy on processing trade, and an enhancement in self-sufficiency thanks to the improvement of the industrial structure. On the other hand, a rise in the demand of raw material required for industrial production is consequently expanding the import weight of preliminary products, and the rapid growth in demand for consumer goods is backed by the rise in income, progress of urbanization and the domestic demand

expansion policy, resulting in the gradual expansion of its share. Of particular note is that the annual average increase rate of consumer goods imports is 26.3% (2009-2014), which is far above the increase rate of overall imports (14.3%).

The top five importing counterparties of China in 2014 were Korea, Taiwan, the U.S., Japan and Germany, the same as in 2009. In the case of Korea, its share in China's import market decreased by a small margin compared to 2009 (10.2% → 9.7%), but as Japan′s share fell by a large degree (13.0% → 8.3%), Korea emerged as China's biggest importing counterparty since 2013. The aggregate share of the five nations in China's import market decreased from 45.0% (2009) to 38.9% (2014).

Korea's export has grown quickly through the supply of intermediary goods and capital goods required for China's economic development, and this explains there is a very close relation between Korea's export to China and China's export. The correlation coefficient between Korea's export to China and China's export during 2001-2015 was 0.9895, which is a very high number indicating there is noticeable co-movement between the two nations. Korea's export to China expanded at an annual average increase rate of 20.6% during 2001-2010, and this dropped to 5.0% during 2011-2014 when China's export witnessed a drastic decline. However, during the same terms, Korea's overall export growth rate recorded 13.4% and 1.0%, showing that export to China has rapidly increased. As a result, China's share in Korea's overall export increased from 12.1% (2001) to 25.4% (2014).

When looking into the trade form of Korea's export to China, the ratio of processing trade decreased from 53.3% (2009) to 51.9% (2014), and the ratio of general trade also decreased by a small degree from 33.7% to 33.4%. As this shows, Korea's export to China displays a structure focused on processing trade, and this is in contrast to the view that China's import is shifting focus to general trade.

A look into changes in Korea's export structure to China by processing phase during 2009-2014 reveals its structure still focused on intermediary goods (75.9% → 79.3%). On the other hand, the shares of capital goods (21.1% → 18.0%) and preliminary goods (0.6% → 0.4%) have decreased. In the case of consumer goods, the export ratio has increased by a small margin (2.0% → 2.3%), but not to the level taken up by China's import ratio in consumer goods (7.2%). An analysis of the market comparative advantage (MCA) in China's import market using data from 2014 revealed that Korea held a comparative advantage in capital goods and intermediary goods. In the case of consumer goods, which are displaying a swift

increase in imports, Korea did not hold comparative advantage. As for shares in China's general trade import market, Korea (5.7%) is falling behind compared to the U.S. (8.7%), Japan (7.6%) and Germany (7.4%).

While China's import structure is rapidly shifting to a focus on general trade and consumer goods, Korea on the other hand is maintaining an export structure focused on processing trade and intermediary goods. Despite this, the export ratio to China remains high, showing that an export structure to China focused on intermediary goods is still valid. However, the swift enhancement of the industrial structure and technology innovation in China calls for a need to reestablish Korea's structure and strategy of export to China by adjusting to structural changes in China's import in the long term.

As China's export suffers a downturn, the import of intermediary goods is consequently shrinking, and the import substitution of intermediary goods is occurring at a rapid pace due to China's technology innovation. Therefore, in order to maintain and expand exports of intermediary goods, an area in which Korea holds comparative advantage, Korea must develop high-tech products according with China's industrial upgrading, and must make efforts at modernization and sophistication of export goods.

To improve the existing export structure that is focused on processing trade, there is a need to diversify export routes to local enterprises as well as to MNC's in China. However, since it is difficult to establish or expand a new distribution network through China's exclusive distribution system, it will be necessary to aggressively develop connecting business with distribution enterprises. A rapid expansion of consumer goods is forecasted, thanks to an increase in demand backed by income growth. Therefore, to boost the export of consumer goods, entry into the local distribution network must be pursued by promoting business co-operation with the online and offline distribution chain in China.

Recently, e-commerce has been emerging as a new consumption trend. In particular, China accounts for 42.2% of Korea's e-commerce export, the largest share of all, and for Chinese consumers' foreign purchases through e-commerce, Korea (34.3%) comes in second following the U.S. Therefore, Korea should further develop e-commerce platforms and e-payment systems to improve the convenience of Chinese consumers, as well as pursue entry into the domestic demand market using e-commerce. KIEP